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Kirkaldy, Adam Willis

The money world

London

1914

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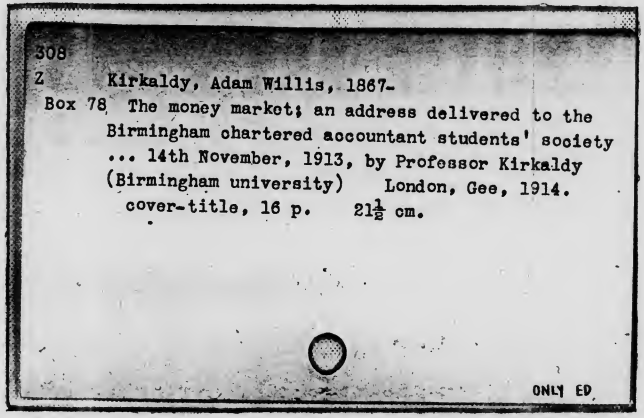
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THE MONEY MARKET.

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THE MONEY MARKET.

By PROFESSOR KIRKALDY
(Birmingham University).

A paper read at a meeting of the Birmingham Chartered Accountant Students' Society, held on the 14th November 1913, the President (Mr. G. T. W. Coleman) in the chair.

Professor Kirkaldy, in opening, said that the title sounded rather formidable; a very big and complicated subject. He thought when he was asked to talk about it, seeing that they, as well as himself and the Chairman, were immersed in technicalities and figures all the week long, it might perhaps be more interesting if they looked at the Money Market from an historical and descriptive rather than from the technical, every-day point of view. The London money market he had heard described as the greatest factor of economic power that the world had ever seen, and he thought that description was on the whole true.

He did not think that they could claim that England was the richest country in the world; he thought that probably France was on the whole richer than they were, more well-to-do in the different grades of population, but they in England enjoyed, and had enjoyed for a very considerable time, an abundant supply of ready cash, which had made them appear even richer than they were, and that supply, and the credit it enabled them to make use of, made their money market such an exceedingly useful institution, an institution which was not only useful to themselves, but had great influence on the whole of the commerce of the world.

When did this money market commence?

If they looked back into English history they would find that when the early Governments wanted to borrow money, and were unable to get what they wanted in this country, they had to go abroad. The Plantagenets borrowed abroad, mostly from the Italian bankers. He thought it was Edward III who repudiated his debts, and it was said that, ever since, a little bill had been presented when each succeeding monarch ascended the throne. It was, so the story went, presented with compound interest, and ran into a goodly number of figures. Of course, it was never likely to be paid, but there was a certain amount of sentiment and interest, especially interest, about it. (Laughter.)

There was no internal money market of any sort in the country until the time of the Tudors. The first money market they could trace was instituted by Sir Thomas Gresham, the great London merchant who built the first Royal Exchange and in 1572 raised the first internal loan for the Government.

Gresham was a very interesting man, and he would advise the students to read his life in the Dictionary of National Biography. He was one of their great British merchants, Lord Mayor of London, a great financier and economist; he studied money and currency, and understood more about it than anyone who had gone before him. They had a very interesting memorial of him in one of the currency laws, which had been called after him—Gresham's Law. Currency in those days was exceedingly bad, and it was found to be impossible for the Government to improve it by simply emitting new full-weight coins. Gresham noticed that new coins disappeared very quickly. So far as money was concerned they might emit large quantities of new silver or gold, but it disappeared from sight. Of course, the reason was, as Gresham found out, if they had two coins which were supposed to be sovereigns, and they had to meet a bill which came to a sovereign, they did not pass on the best sovereign, they passed on the inferior, if the creditor would take it. The economic law was to the effect that bad money

tended to drive good money out of circulation, and overvalued coinage drove out undervalued coinage. There were some interesting examples of that: for instance, when English merchants got in touch with Japan fifty or sixty years ago and Japan was opened to foreign commerce, the coinage consisted of gold and silver coins—the gold was called a Kobang, worth about 18s. 5d., and the other, a silver coin called the Itzebus, worth 1s. 5d. The ratio was fixed in Japan at one Kobang to four Itzebus, so that for about 5s. 8d. they could get gold of the value of 18s. 5d. A number of English merchants had gone out to Japan expecting to stop twenty or thirty years, and then come back with a competency. They found, however, that in a very short period they could become quite wealthy by buying up the gold currency. The Japs found that their gold was disappearing. When the people "in the know" had got all they could, they let out the secret. The overvalued silver had driven the undervalued gold out of circulation. The Japanese Government then reformed their currency.

Up to the early nineties of the last century in England they had all sorts of gold coins—George III and IV and William IV and early Victorian, some of them considerably worn—in circulation; consequently there were a number of light coins circulating. The Government determined to put the gold coinage on a satisfactory footing, and as a result of the measures there taken they have got the best gold coinage in the world. The Government issued notices that they were going to put the gold coinage, at the expense of the country, in a thoroughly good and efficient state. Anybody having old gold would, on taking it to the bank before a certain date, receive full value for it. After that, those holding light gold would have to stand the loss.

He saw an interesting incident as to what happened just after the currency law came into force. A man in a bank was paying in some gold. It was put in the scale and found to be light. The clerk sorted over the coins and

found a light sovereign. He immediately took a pair of shears from under the counter and cut it in two. The man asked him what he was doing with the sovereign, and the clerk replied: "It is not a sovereign; it is only "18s. 3d. I can credit you with that amount if you like, "or you can sell it as gold." The man blustered, but finally accepted the account credited, and went away muttering. That was why their gold coinage was in such good order. There they had two illustrations of the working of Gresham's law.

Practically from the Tudor times they had had some sort of a money market in London. Under the Tudors, trade and commerce began to develop very fast, and the merchants became more and more wealthy. There were no banks in those days as they knew them. When a merchant had accumulated a quantity of wealth in the shape of coin, there were no paper credits except a few bills of exchange, no bank-notes or cheques—bank-notes did not come in until the time of the Stuarts, and cheques until 1771. When the merchant had a surplus of money he used the Tower of London as a safe deposit. That was all very well when they had honest Kings and Governments to deal with, but some countrymen of his (the Professor's) came to the throne who were not exactly honest, and Charles I appropriated some of the merchants' deposits in the Tower. The merchants, naturally, after that deposited no more there. (Laughter.) Then came the question of what the merchants were to do with their spare money.

A happy thought struck them. London had a very important quarter, known as Lombard Street, peopled by goldsmiths. Those goldsmiths had very strong and roomy fire-proof safes in their cellars and running under the street. They were well known for their integrity and honesty, and as soon as the Tower of London was no longer safe the merchants began depositing their money with the goldsmiths. There they got the beginning of the modern money market, because, when a man took a sum

of money to the goldsmith, the latter gave him a receipt for the amount, and some of the goldsmiths accumulated a large quantity of money in that way. The money was deposited at call. They could get it out at any time or take a part of their money and have their receipt endorsed, so that the goldsmiths were ostensibly never very sure how much money would be with them. A great deal of experience was, however, gained, and they found that about 20 or 30 per cent. was all that they need keep in their safes, as that would be quite sufficient to meet calls that were likely to be made. The goldsmiths then began using the other 70 or 80 per cent. that was not likely to be called for, for financing people. For instance, they financed the Commonwealth under Cromwell. It was largely through that that Cromwell was able to pay his troops so regularly, and that was one of the factors in the defeat of the Royalists. The receipts were useful because people found they could pay accounts with those slips of paper as readily as with money itself. As the money was absolutely safe with the goldsmiths, it was in those troublous times very much safer to pay their debts with the receipts and leave their money in the hands of the goldsmiths.

The latter found that to be a good paying business step. They not only took care of peoples' money for them, but began offering a small percentage for deposits in order to increase the sum of money they had available for lending purposes. They discovered, too, they could issue vouchers on their credit. In this way they found that a sum of money deposited could be very much increased in amount for money market purposes. So they found the money market developing in a very interesting way, and those goldsmiths gradually became bankers. That was the origin of the English private bank.

The country banks started in very much the same way. Some of them had a very interesting history. Let them consider, for instance, Smith's, of Nottingham. Mr. Smith was a draper in Nottingham. There were highwaymen about at that time. The farmers came into Nottingham on

market days to sell their stock, and would often take a considerable amount of money. At the end of the market they generally sat down to the farmers' "ordinary," and washed it down with good ale, or perhaps something stronger, and they sometimes went home in a happy condition. It was naturally a temptation to highwaymen to stop those men and relieve them of their money. One of the places visited by the farmers on market day was Smith's drapery store, when they wanted to buy something for their wives or sweethearts. One day Smith said to one of them, "You have got a lot of money there." "Yes," was the reply, "I am rather scared about it. "Look here, will you keep it for me until next market "day?" Smith consented, and gave a receipt for the deposit. Other farmers who had been relieved of their money heard of this, and followed the example. Smith, after some time, discovered that there was always a quantity of money that was not asked for. First of all he used it to increase his business. Next he began lending to his neighbours at interest. He was perfectly solvent, and could meet all calls made upon him, and gradually by this means he got his experience as a banker in a small way. He found, too, that the business paid him, and he began to pay a small amount to farmers who left their money, and especially if there was a notice for the deposit to be returned within a certain period. Then came one day when he sold his stock, called in the painter, and painted out "Smith, draper," and put up "Smith, banker."

There they had the origin of the country bank and the London bank, and the origin of the deposit system, which became popular, and had become more and more popular in that country—in a word, it was one of the secrets of their money market. Not only did the farmers begin to deposit in the way described, but the merchants in London also. The goldsmiths turned their business into banks, and began offering interest upon deposit, while they began to increase their business by offering to collect rents for wealthy landowners. Gradually other

sections of the community saw the advantage of depositing their money with bankers, for their bankers had always held a high, and a justly high, reputation for integrity and honesty. The people found it was more convenient, and safer, to leave their money in the hands of the bankers than to carry it about with them.

Turning to the Continent, one could see why the integrity of the British banker led to the popularity of the deposit bank in England. The reverse had been the experience in France. Until recent years banking in that country had been carried on in a comparatively small way. The reason was that the kings under the *ancien régime* used to make use of the deposits if they were hard up, and the thrifty Frenchman, after putting his sous in the bank, and then finding them taken by the Government, got tired of depositing them. Instead of being attractive, the system made the people suspicious; indeed, the average Frenchman even now preferred hoarding his money up in his own house rather than putting it in the bank. That was one of the reasons why, although richer than they, France did not command the ready supply of cash and credit to be found upon the London market.

If there were a million people with £20 or £30 each, and they hid it under the hearthstone or put it in an old stocking, they had got a sum of twenty or thirty millions. That was a vast amount of wealth, and very useful to the possessors, but of no good to the community among whom they lived. If it was deposited in the bank under conditions such as existed in England, where there was a "one-reserve" system, that money naturally flowed on to the money market, and they had a growing sum of money available for commercial and other purposes. It was a big borrowable sum, and it was very much increased by that phenomenon which the goldsmiths became conscious of; it had attached to it qualities which, as they knew, enabled them to use it to a very much greater extent than its actual nominal amount. The goldsmiths had turned into bankers, and were carrying on the business on more or less modern lines, but another interesting thing

had occurred. Owing to religious troubles, Amsterdam had become the great commercial centre of the world. All commerce had tended to concentrate in Amsterdam. Ships from all parts of the world went there, and cargoes were distributed from there, and the town began to take up a position both for wealth, and commerce, and money, such as London enjoys at the present time.

Englishmen wished to take part in the trade. They had started as a sort of buccaneers and pirates under the Tudors, but under the Commonwealth they had commenced genuine business. They made a bid to take away from Holland the trade they had got, and they succeeded in getting hold of the best part of the commerce of the world. London took the place of Amsterdam.

Amsterdam had suffered a great deal through bad currency at the end of the sixteenth and beginning of the seventeenth century. The Dutchmen often found, when they had carried through what appeared to be a promising transaction, that when they came to settle, the profits had considerably diminished or disappeared altogether. To obviate this, the Bank of Amsterdam was founded in 1609. It had a very special and efficient currency, instituted by means of book credits, and that put the commerce of Amsterdam and the world on much safer lines.

When the business tended to come to London the Londoners wanted to have a bank of their own, and there were many schemes put forward. Towards the end of the seventeenth century it became more and more necessary that there should be some big credit institution in London, and a Scotsman named Paterson brought out a scheme. He was a most interesting man, whom the students ought to know a good deal about. His friends said he had been to the West Indies as a missionary, and his enemies said he went there as a pirate. (Laughter.) At any rate, he was a good business man, and he started a scheme which in 1694 led to the foundation of the Bank of England. Although a monopoly of banking was not given to the Bank of England by its first Charter, it was thought that

by subsequent Charters that a monopoly of joint-stock banking had been given to that institution. The reason for that was that the old goldsmiths made their principal profits out of note issue, and it was thought that if the Bank of England was given the monopoly of note issue it had a banking monopoly, whilst as a matter of fact the Charters only conferred a monopoly for note issue. The opinion that the Bank enjoyed a monopoly of joint-stock banking was held until about 1830, and it was believed that no other joint-stock bank could be created. In about that year, however, an inquisitive gentleman named Joplin made a few inquiries as to whether the monopoly really did exist. The Bank of England Court informed him that they had the full monopoly of banking under their Charter. Mr. Joplin asked to see the Charters, and on going through them he found that, as he (the Professor) had stated, the monopoly only referred to note issue and that joint-stock banks could be founded so long as the issue of bank notes was left alone. Under Lord Althorp, in 1833 another Charter was issued, and the establishment of joint-stock banks permitted, with the provision that they must not issue notes.

That had been another of the big things accomplished in connection with the money market, and had been one of the great safeguards and one of the great means of developing their commercial and manufacturing interests, because about the year 1833 the London and Westminster and other joint-stock banks were founded. Those banks became the banks of the commercial people. The private banks were the banks of the aristocracy. Those banks, with their developments, were one of the main factors in the London and the English money market. The reason was that those banks had always been exceptionally well managed, and having won the confidence of the people they had attracted deposits. To such an extent had that been carried at the present time that those banks had their branches not only in every town but in every section of a town.

Let them take London, and go round the new residential quarters, and they would be surprised to find the many branches that exist. They may wonder how they can pay. Englishmen as a rule keep practically nothing in their pockets except a little cash. Every sovereign the Englishman got went into the bank; all his payments, even quite small ones, were made by cheque. The reason why those banks had so many branches was that they had found out, among other things, the value of the monthly housekeeping cheque. It was the custom of the housewife, instead of having her money in notes or gold, to have an account at the bank; she made her payments by cheque, and she had a double voucher for her payments—the receipt and the cheque. The advantage to the community was this, that the whole of the money represented by those accounts was available for the money market.

About forty years ago those banks had in deposits some hundred millions; now they have about eight hundred millions. If they divided that money between a million people having £800, and put it under the hearthstone, or hung it up in a stocking, it would still be a vast sum of money, but it would not be much good to the community; but get the whole of those people to put that money in the bank, and it was available, or the greater part of it, for the money market.

A curious thing about the great Bank Charter Act, which remodelled the Bank of England, and which put our note issue on a safe and sound basis, was that at that time there were 72 joint-stock banks and 205 private banks, all with the rights of note issue. He thought if they turned up the last Banking Supplement of *The Economist*, they would find that that large number of separate banks had been reduced to about a dozen, but there came out one of the great developments of modern trade, commerce, and business. Although the separate establishments had so enormously decreased in number the facilities for banking had increased out of all knowledge. Even in the last few years the number of banking branches had increased about four or five fold. In 1897 there were 1,200 or 1,300 banking offices in England and Wales; at the present time it was nearer 6,000. Although the number of different banks was enormously decreased owing to amalgamations, facilities for the people to bank money had increased to the extent indicated. What were the constituent parts of the money market? At the present time there were about six, but in ordinary parlance only three were taken into account when the term "money market" was used.

There was the Bank of England.

There were one or two of the more important private banks.

There were the great joint-stock banks.

There were the discount houses and the bill brokers.

Rather outside banking they found in London, and perhaps in one or two of the provincial towns, one or two considerable mercantile houses, which from time to time had a certain amount of cash which was available for the money market purposes.

Then they had at intermittent intervals cash from the Stock Exchange. As a rule, those were rather customers to the money market, but occasionally they had more money than they could use, and then it came upon the market.

The most important of those six constituents were the joint-stock banks, the discount houses, the brokers, and the private bankers. The students would notice that he had excluded the Bank of England. At one time the Bank of England had considerable control over the money market, and it was a very good thing it had; it was rather a disadvantage, and there was a certain amount of danger connected with the fact that the Bank of England had lost a certain amount of its control. At the Bank of England, practically speaking, the inflow and outflow of gold was focussed.

In 1844 twenty-two millions of paper was allotted by the Charter Act—eight million pounds to the issuing banks, and fourteen millions to the Bank of England. The eight millions allotted to country banks had been practically reduced to nothing, there were but a few thousand pounds of outside issues left. For all practical purposes the Bank of England had become the one issuing means.

They had in the Bank of England one bank which controlled the currency of the country. It was very necessary, in order that the business should not be hampered, that there should be just the right amount of currency in the country to circulate the business. The object of Sir Robert Peel's Charter Act was to give to that one institution the control over the whole of the currency, so that by means of the bank rate when there was threatening to be too much money in the country to be able to drive some of it abroad, and if there was likely to be stringency to be able to attract some from abroad. It was a good thing that the Bank of England should have control over the money market as it had over the currency. That control was exercised in various ways. If the bank rate was raised it attracted money; if lowered, it drove money abroad. At one time the Bank of England was not only able to fix the bank rate, but make it effective. It was a good thing it was so; although the Bank of England was not a Government concern, still the position it held was so important that the Government very frequently confided secrets to the Court of the Bank which were not confided to anyone else. When there was political trouble brewing a hint might be given, and sometimes a hint of that sort brought about a change in the rate. The information which caused that was not known outside. Until recently the Bank of England had always made the money market respond. The Bank would go on the market itself and borrow until the market did respond, but for the last three years there had been exceptions to the rule. That was first noticed in about 1910, when the Bank of England raised the rate, but the market did not respond. It was noted that the Bank was borrowing and holding the money, but the market not responding by altering its rates. In that and in other ways the Bank had tended to lose its control, which in some senses was an element of danger.

On the other hand, the joint-stock banks, owning an enormous amount of deposits, were a great power on the money market.

As they were aware, the Bank of England was the bankers' bank. All the joint-stock banks and other banks kept their reserve at the Bank of England, and they had what was known as the One Reserve System. When they had seen the figures of the reserve of the Bank of England they had practically seen the reserve of the whole country. Thanks to this one reserve system, it was true, as Paget said in his book "Lombard Street," that "Capital, like water, tends to flow where it is most wanted." If they watched the Clearing House they would see that in certain wealthy counties there was a superabundance of money. They saw money put into the local banks. That money gravitated to London, and then it went to Lancashire, Yorkshire, or other parts of the country where capital was needed. They thus saw in this country, thanks to their system of banking, capital tended to flow where it was wanted. A man might be quite poor himself, but if he had a good character for integrity and honesty all people would put trust in him; and if he was connected with anything likely to pay a dividend, he was always sure, under normal conditions, of getting what he wanted.

What had the money market done for us?

The effect of having that large accumulation of money and of ready money was that we were in a most advantageous position for picking up all the commercial plums that were going. An old illustration of that was what happened when the Suez Canal was opened. The trade of the world at one time centred in the Mediterranean. Amsterdam lost its position; London, Liverpool, and Hamburg became big commercial centres. M. de Lesseps determined that the Isthmus of Suez should be pierced and a new sea route opened up. He was opposed especially by England, for we had constructed ships to go by the long old sea route, but they were not suitable for the Canal traffic. De Lesseps, however, was a man of iron will; he succeeded in his enterprise, and the Canal was opened in 1869. If they looked at some of the literature of the 60's they would see that it was stated that the Mediterranean would once again have the commercial

ports of the world. What happened? They would find that the Western European ports, notably London, still held their place. What was the reason? There were two factors. One was our shipowners and the other our bankers.

The shipowners of England showed themselves to be business men of the highest calibre. They had one great trait—their word had always been as good as their bond. The Suez Canal was opened, and it was necessary, if it was to be used to advantage, that a special type of ships should be built. One of our companies "scrapped" half-a-million tons of steamers and built new ones. It was able to do that, first because of its own initiative, and secondly because there was the money market in England, which enabled it to get the sinews of commerce. When the new route became a possibility, while the business people of France and other countries were considering ways and means, our ship-builders had gone to the money market, got what was wanted, and built the ships. They took the trade, and had held it ever since. Ever since the opening of the Canal 60 to 70 per cent. of the shipping going through that Canal was British. Although the effect of our money market was most important, it must be remembered that ours was not the only money market.

Now they had a new canal on the verge of being opened—the Panama Canal. Already not only their own shipowners and merchants, but American and Germans and Japanese were scheming to get the benefit of that new route.

"Watch," said the Professor, "the matter in the light of what I have been saying. The whole thing hangs upon two points. First, the ability of our shipping interest; and secondly, our money market. My final word will be this:—At the present time, so far as one can see, if you look across the world and study the business men in the chief countries, putting it roughly, you may see that the Englishman is not only the leader, but the ballast of the commercial world. So long as he maintains that particular position we have very little to fear. If he gets affected by the speculative ways which are fashionable on the other side of the Atlantic, if he loses the position he holds as being a man of integrity and

honour, he will imperil the other position. It is a very interesting situation we are facing, and during the next four or five years there are many things that will be well worth watching."

Replying to a question regarding the Suez Canal, the lecturer said one of the big things in maintaining their supremacy on that route would be getting methods of producing coal as cheaply as the Americans, and being able to supply their ships along the route on fairly even terms. They exported many million tons of coal every year to the coaling ports of the world for the use of their ships. Exporting that coal enabled their ships to go out loaded and bring back goods for manufacture. The coal trade had given them their shipping supremacy. When the sailing ships were to the fore the Americans nearly got ahead with their mercantile marine. With steam and coal the British took the lead and held it. If the Americans got cheap coal, and started a line of coaling stations supplying cheap coal on their new route, it would be a serious thing.

Asked if the adoption of oil fuel would benefit us, Professor Kirkaldy said:—"As you know, there is a ring in oil which it is difficult to break, but fortunately that ring is going to be broken. The British Government have refused to give monopolies to certain people, and the oil resources of the British Empire are going to be developed in the interests of the Empire and not individuals. In Canada we have enormous possibilities of oil, and the same thing obtains in other parts of the Empire. It is estimated that if our oil resources are worked we shall be able to hold our own with any country, either America or Russia, which is likely to come to the fore. Scientific people in connection with the fuel question tell us that we shall not use coal very far from the collieries where it is worked. It will be turned into gases and oil of grades, and we shall use those gases and oil for our ships and other things. There, again, you open up an interesting point. If we lose our supremacy on the routes while coal is to the fore, if the Americans once get in and our trade is crippled, then they will be able to hold their own with oil, but if our colliery proprietors and miners will take note of these facts and for the next few years

make it their business to hold their own on our own routes and coaling stations, and defy American competition, it will give us a chance to develop our oil resources and get our oil stations organised, and we shall be able to keep our supremacy."

Replying to another question respecting the comparatively small amount of reserve capital in England in comparison with other countries, Professor Kirkaldy said :—At the time of the Agadir dispute we were within an ace of a war between France and Germany. The thing that stopped that possible war was that, although the German military party was ready, the bankers had not sufficient gold to finance a war, and so the Germans climbed down, but ever since then Germany, France, and Russia have been laying hold of every ounce of gold they can get. In America they have a comparatively large amount of gold, but a few years ago they had a currency crisis. America has three or four times as much gold as we have, but it is dissipated in many centres.

While we had a comparatively small supply of gold during that time of crisis, we were able to finance them with gold to a considerable amount, an operation which paid our bankers hands down. It was an interesting thing to see a country like England financing a country which had a much bigger stock of gold, able to carry on its business with practically no trouble, and making a big profit out of it. It shows the advantage of our combined reserve, which was at one time criticised as being wasted energy. For years our joint-stock companies averaged 15 per cent. reserve, and were able to pay big dividends. The Bank of England proportion of reserve to liabilities was 50 per cent., and the Bank paid about 10 per cent. dividend. They could, of course, have reduced their percentages and increased their profits, but the directors preferred to maintain the high proportion and pay small profits. We have this advantage of the one reserve—with a comparatively small amount of gold we get the maximum of efficiency.

On the proposition of Mr. H. G. Wilmott, seconded by Mr. G. S. Coleman, and supported by the Chairman, a very hearty vote of thanks was accorded to Professor Kirkaldy for his address

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